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THE BANKING AND CURRENCY ACT OF 1913. I

I

The Aldrich-Vreeland act of 1908,[1] passed largely for political effect and expiring July 1, 1914, was the cover under which preparations were made for a thorough revision of our currency system. That act was negative in its working, and no resort was ever made to its provisions for issuing emergency notes through currency associations. In the autumn of 1912 and 1913 the tension of credit was probably as extreme as in 1907, but, as was to have been expected, no use was made of the act. The essential theory of it was the obvious dependence on an issue of bank notes as the remedy for a stringency; while, in truth, the difficulty lay in the shortcomings of our credit organization. Deeper than the inelasticity of the bank issues lay the inelasticity of credit and of the power to lend. It is interesting, therefore, to watch the development of recent reform proposals and to see how far they showed an understanding of the real weaknesses of our banking and monetary system.

The formation of currency associations under the act of 1908 was urged by Secretary MacVeagh on the various clearing-house centers; but they were organized with much skepticism as to their actual use. The tax on the notes was unintelligently heavy, making their use

[1] For a full study of this law, see the article by the present writer in the *Journal of Political Economy* for October, 1908, pp. 488–513.

almost prohibitory. On the other hand, if resort had been made to these notes rather than to clearing-house certificates, they would have had the advantage of a circulation wider than the narrow field of the certificates. Since they could not, however, be used as lawful reserves by national banks, they would not, in fact, have touched the lending power of these banks as directly as did clearing-house certificates. If A could not get a loan or extension at Bank X, and transferred his account to Bank Y on the promise of notes to be obtained through a currency association, A might have used these notes to take up his obligation held by Bank X; the next day Bank X would have presented these notes to Bank Y as a demand obligation against cash reserves; thus they would not have been so useful as clearing-house certificates which could have been used in settling balances between banks. Yet, apart from the tax, some bankers believed that these notes would have been effective in time of stress. Certainly, by being paid out to the public, they might have prevented, to some extent, the drawing-down of banking reserves of lawful money. At the best they could have been only a palliative. Yet it should be noted that these notes, whatever their efficiency, broke with the past unmistakably by being obtainable on the pledge of other security than United States bonds.

The provision in the act creating a National Monetary Commission had important consequences. Its composition, however, was typical of our methods: the 18 members were chosen equally from the two houses of Congress, and practically none of them were experts. Consequently, the education of the Commission itself was the first duty, and a considerable number of treatises were prepared at the behest of the Commission on topics more or less pertinent to the subject. Probably few persons ever read them all; they had little influence on members of Congress, and practically none at all on the general public. They were, indeed, desirable to special students of banking. The formation of a concrete plan of reform, however, came through the visits of the chairman and some others to Europe and through other influences. It is to the credit of the chairman, Senator Aldrich, that, in comparison with his attitude in 1908, he performed a complete *volte face*. European experience, well known already to American students of this sub-

ject, was now driven home on those who might influence the action of Congress. But the definite outlines of the plan presented January 17, 1911, must have been due to the suggestions of a few experienced persons in this country, who were consulted by the chairman near the end of 1910. Whatever its origin, the plan actually laid before the country had the distinction of attacking the pivotal weakness of our system—the organization of credit. That was an epoch-making advance. Into the personal and political animosities connected with the chairman of the Commission it is needless to enter here; but in getting legislation it is obvious that political prejudices are facts as much as stone walls, and they had their due influence on the result.

II

In fact, political considerations were ruling in regard to a subject which of all others ought to have had nonpartisan treatment. During 1912, every effort was made to keep the currency question out of politics. The fact, however, that the plan was intimately associated with the name of Senator Aldrich, the head of the Protectionist Republicans, was present in everyone's mind. This fact forced the question into politics. The Commission, from the Republican point of view, made the fatal mistake of waiting four years before presenting its report until the lower house became Democratic. The reaction in favor of the Democratic party made it patent that no bill unsatisfactory to the Democrats could become a law. But the demand for nonpartisan action was still so great that even Democratic leaders believed that, while the matter could not be brought up in the winter session of 1911–12, just before a presidential campaign, it ought to be taken up in the short session of 1912–13. Political events, however, swept these hopes aside.

The Democratic Convention at Baltimore saw a struggle between the conservative and radical elements of the party in which, in a sense, the latter won. Although Mr. Bryan could not control the result, neither could the conservatives. The nomination of Woodrow Wilson, who was not Mr. Bryan's candidate, created a situation that made it seem necessary to placate Mr. Bryan by allowing him to write the platform; and the currency plank arrayed

the party against "the so-called Aldrich bill or the establishment of a central bank."[1] The danger of making the subject a party issue was diminished, however, by the Republican platform, which declared only in favor of general principles and not for any specific plan. Consequently, the currency issue was little heard of during the campaign. The eccentric declaration of the Progressive platform drew no discussion. Very early in the campaign it became evident that Mr. Wilson would be elected. The election of a Democratic Senate later gave his party control of legislation. Hence Democratic leaders had no disposition to allow a currency act to pass in the short session, when they could very soon stamp their own impress on the most important problem up for solution since the Civil War—least of all a measure regarded as the handiwork of Senator Aldrich, a Republican leader.

While Mr. Wilson spoke of giving the question nonpartisan treatment, he had elements in his party difficult to be unified on common ground.[2] As early as September, 1912, it was known that the Pujo subcommittee of the House, dominated by its counsel, Mr. Samuel Untermyer, intended to report specific monetary legislation in connection with the investigation of the "Money Trust." This policy infringed on the legislative work of the Glass subcommittee. The conflict finally ended in the triumph of Mr. Glass (who in the extra session of the new Congress, April, 1913, became chairman of the full Banking and Currency Committee). In the meantime, by the summer of 1912, the so-called Aldrich Plan (reported in January, 1911, to both House and Senate) seemed to have become politically dead. In November, 1912, the Glass subcommittee was spurred into activity by the work of the

[1] It has been claimed that the true draft was altered by the omission of the letter "f," and should have read "Aldrich bill for the establishment of a central bank."

[2] The radicals in the House, like R. L. Henry of Texas, wished extreme action in connection with the investigation of the "Money Trust," hoping to get useful campaign material. The resolution demanding this investigation was finally sent to the Banking and Currency Committee, where it was given to one-half of the committee presided over by Mr. Pujo, then the chairman of the whole committee; while the other half of the committee, to be presided over by Mr. Carter Glass, next in rank to Mr. Pujo, was intrusted with the definite task of preparing legislation on banking and currency. To Mr. Glass's subcommittee the plan of the Monetary Commission and other bills were also referred.

Pujo subcommittee. Up to that time, tentative Democratic banking bills did not go far, even proposing to leave untouched the existing inelastic national bank notes secured by bonds. In fact, having seen divisions in the party because of silver and other monetary issues in the past, Democratic leaders were loath to take the chance of arousing discussion on these questions. Politicians hoped to dodge serious legislation by postponing it.

Meanwhile public opinion, developed in a systematic way, had become intelligent and insistent in favor of thorough and constructive legislation. Foreseeing that this could come only through the Democratic party, the South was made the objective of an active propaganda in favor of banking reform.[1] So vigorous and successful was this work that, later, a Democratic Congress found many of its constituencies demanding legislation of a sound, specific character. In the Sixty-second Congress, in the Democratic House, the radicals were outnumbered 2 to 1; and in the present Sixty-third Congress the ratio is probably about the same. A Democratic Congress, therefore, called in extra session as early as November, 1912, by President-elect Wilson, now had to face the problem from which there was no escape. Then Mr. Wilson's firm, guiding hand appeared. He was evidently advised of the progress already made by the Glass subcommittee, but he kept his own counsel. From the very date of the calling of the extra session in November, the chances of currency reform seemed suddenly to become favorable. To Mr. Wilson's championship more than to any other force is due the final legislative result. It was expected

[1] The National Citizens' League for the Promotion of a Sound Banking System, with headquarters in Chicago, began a campaign of education throughout the country in June, 1910, giving main attention to the South, and to Progressive states in the West and Northwest. Effective organizations were established in forty-five states, chiefly among business men. Contributions were solicited from banks on the ground that they represented also the borrowing business public, who were mainly interested in the reform. A vast amount of material was printed in the newspapers and pamphlets, while a volume on *Banking Reform* (1912, xxiii chapters, 8vo, pp. xii+428) was published. For the man in the street simple exposition was supplied in a fortnightly issue and in newspapers; but the volume on *Banking Reform* was a textbook for use by editors, speakers, and congressmen. Speaking was had especially in the South. The purpose of this organized and systematic work was to create public opinion in the home districts, and it had the expected result in the final votes in Congress. The League stopped its work November 1, 1913.

that a banking and currency bill would, if possible, be taken up in the extra session (spring of 1913); and the Glass subcommittee had held hearings in January, intending to have a bill ready by the time the extra session convened.

The still larger political significance of banking and monetary reform, however, cannot be disregarded. It is well known that the Democratic party had in past years sympathized with the pleas for unsound paper money, and had been committed to the free coinage of silver. The Republican party, it is true, was on its side responsible for the silver act of 1890; but during the control of the Democratic party by President Cleveland his party was, with remarkable generalship, manoeuvered into a position of soundness on the silver question. When Mr. Bryan gained control and enforced on his party his views in favor of the free coinage of silver, and the issue of all paper money by the government (involving the retirement of national bank notes), the Democratic party was successively beaten in every campaign which pivoted on those issues. It was not the strength of the Republican party, but the aberrations of the Democratic party on banking and currency, which drove a majority of the voters to elect Republican presidents. In view of the disasters which had come upon Democrats through monetary issues, it is easy to understand the reluctance of their leaders to take them up just when party success in the national elections seemed possible. Nevertheless, the development of industry in the South, and the spread of a business, rather than a political, point of view on currency questions throughout Democratic states brought a growing belief that only by passing a great constructive act on banking and currency could the Democratic party wipe out the distrust due to past eccentricities on those issues, and win that confidence from the business element which was essential to remaining in political power. The remarkable statesmanship by which President Wilson, with the aid of Democratic leaders, put their party behind an epoch-making, constructive measure and passed it on December 23, 1913, is a monumental event in our political history. It assumes the character of a political miracle. No little credit for the political result should be assigned to Mr. Bryan, who brought his large following to the support of the meas-

ure. Hereafter, the political lines on money and banking questions must be drawn in entirely new ways. The effects of this act on both our business and our political development can scarcely be exaggerated.

The actual result of the new law is remarkably good; but the opportunity ought not to be let pass without comment on our American method of legislating on subjects requiring expert knowledge and experience. There is a certain assumption (with some rare exceptions) that election to the House or Senate of our national Congress makes the member an expert on all subjects that may come before him. In other words, even the members of committees are not experts; and yet these members usually insist on introducing their personal convictions into proposed bills. Members often publish to the world by their questions an abysmal ignorance of the subject before them. Hearings are usually held, not primarily to have various sides of the problem presented to experts, but to enable the ignorant member to be taught and to understand some of the obvious parts of a proposed measure. In hardly any other country in the world would inexpert legislators attempt to construct a bill. The matter would be first referred to a committee of impartial, trusted experts, whose report would then be thoroughly threshed out by the legislators who are responsible to public opinion. Yet with us, the fact of election to Senate or House seems to create in the minds of those elected a suspicion of outside advice. Since men who are primarily politicians, and have little or no expert knowledge or training, must be personally convinced before a bill can even be reported from a committee, it is a perpetual wonder that workable laws on technical subjects are ever passed. What is the conclusion? The actual process of legislation is not what on the surface it seems to be. The bill is not passed on its merits; for very few of those who vote on it know anything of its merits. This outcome may be said to be the necessary result of committee government. Not wholly; because that theory assumes that committees are experts, which they are not. The conclusion is that an important act gets on the statute books, in our political system, only as a part of a given party policy. The man in command of the party's fortunes, or the few leaders

who work with him, agree on a measure and it is "put through" by the dominant party, even though these leaders know very little of the subject. The system as thus described is probably the reason why our laws on currency and banking have been so defective; and it may also explain why, by a happy conjunction of events, a remarkably good act has been passed, although few of those who passed it really understood the essential features of it.[1]

III

The problem of banking and currency reform was complicated by a confusion of mind, even among bankers, in regard to the various kinds of banking which might be carried on by any one institution. We were in the midst of an evolution, not only in our business, but in our credit, organization. The banking organism, which had seemed fairly homogeneous, began to be resolved (as if by some gigantic magnifying glass) into parts having separate functions and purposes. Already the trust companies, organized under state laws, while retaining their original departments, had developed departments for commercial banking creating demand liabilities. Meanwhile national banks, although essentially commercial institutions, began to establish savings departments. Then, the growth of investment banking, and the promotion and distribution of securities to meet the phenomenal growth of savings by investors large and small, in a country of rapidly expanding wealth, assumed an overshadowing magnitude, and colored the whole character of American banking and finance. In addition, the fact, well known to economists, began to be recognized by Americans generally, that we had no institutions to cover the demands for agricultural credits in rural districts. The interrelations and analysis of these elements in our banking system are alluring and need a large treatment by themselves, and this must be reserved for another time and place; it is possible here only to refer to them in order to get a fairly clear understanding of the new legislation of 1913.

Most of the national banks, as well as those under a state system, were carrying on two distinct kinds of banking under one

[1] For some light on the origin and legislative history of the bill, see H. P. Willis, in *American Economic Review*, March, 1914, pp. 1-17.

management. The test of a commercial bank is that it creates demand liabilities; consequently, it should hold only assets (chiefly the results of loans at short time based on actual transactions in goods) that are liquid and can be quickly or frequently converted into cash. The creation of demand liabilities (chiefly in the form of demand deposits) requires as a condition of sound banking a special kind of assets readily adapted to meet an instant demand. But the holding of investment securities by commercial banks has reached enormous figures; and any general demand for liquidation of long-time securities in cash could not be met; because an offer on a large scale would result in a great fall in the stock market, the weakening of collateral held for loans, and an impairment of all credits, without creating the desired cash. The desire to share in the profits of promotions led commercial banks to tie up resources in non-liquid form, with the expected results in time of panic.[1]

This confusion between commercial and investment banking, which was characteristic of the great cities, found a counterpart in the small rural banks of the West and South. They too held investment securities; but they confused two distinct kinds of banking in a different way. National, as well as state, banks in rural communities created demand liabilities; but because short-time commercial paper was often limited in supply, and because there were no institutions dealing with agricultural credits, the rural banks to a greater or less extent put their resources into paper based on land, or in non-liquid form. The confusion in regard to different kinds of banking in rural districts was thus matched by that in the great cities. The consequences were obvious: in the latter the essentials of reform were obscured by the hue and cry about "Wall-Street control," which originated

[1] The holdings of securities other than United States bonds by all national banks, on January 13, 1914, were $1,020,494,711, of which $566,246,910, or more than one-half, were held by banks in the eastern states (New York, New Jersey, Pennsylvania, Delaware, and Maryland); $45,255,914 by the southern states; $215,119,106 by the middle western states; $34,792,121 by the western states; and $65,155,202 by the Pacific states. It is to be noted, however, that the national banks on the same date show savings deposits (presumably time deposits) of $855,914,458, of which country banks held $755,914,458. For a further study of the legality and policy of security holdings of national banks, cf. J. H. Hollander, *American Economic Review*, December, 1913, and J. V. Hogan, *Journal of Political Economy*, November, 1913.

really from promotions and loans on securities; while in the former, the desire to help the under dog (or small bank) led to provisions for rural loans wholly inconsistent with the refusal to accept loans on stock-exchange collateral. Such is the way of legislation in a democracy.

IV

In order to be able to test the new legislation, it will be interesting to summarize here the defects in our banking and currency system which were generally accepted at the beginning of the recent campaign (1910–11): an inelastic bank-note circulation; an even more dangerously inelastic credit system; ineffective use of a large supply of gold; a scattering of reserves and lack of co-operative action by banks in times of stress; a rigid reserve system which induced panics; state banks and trust companies doing a commercial business but in different systems; an independent Treasury divorced from the money market which imperiled bank reserves in times of difficulty; the drift of idle funds to the call-loan market where they fed stock speculation; and the want of American banking facilities in other countries to aid our foreign trade. It will be fitting to watch as we go on whether these demands, which were formulated before the new law was even drawn up, have been effectively covered.

We may now proceed to an examination of the act of December 23, 1913. In order to secure clearness it may be best to discuss its provisions under some general heads, and under each head to include the history of the various proposals, as follows:

1) Control and Organization
2) The Federal Reserve Banks
3) The Note-Issues
4) Disposal of the 2 Per Cent Bonds
5) Reserves
6) The Organization of Credit
7) Clearings
8) A Discount Market
9) Foreign Banking

V

Around the question of organization and control centered the main antagonism to the plan of the National Monetary Commission, which proposed a National Reserve Association as the means for centralizing reserves and thus preventing the admitted evil of scattering of reserves existent under the old system. Under this plan an elaborate organization was built up, beginning with local associations of banks which elected directors for district institutions of which there were to be fifteen in the whole Union; these fifteen directorates were to elect a central governing body of forty-five, with an executive committee of nine, in power over the National Reserve Association, under which the fifteen institutions were to be branches. It is to be observed that the directors of the central body were to be chosen by the representatives of the banks. Such an institution was not, in the usual acceptance of the term, a Central Bank, because it would do no business with the general public. Nevertheless, having one central directing body, opposition was raised against it on the ground that effective control over it might be obtained by ambitious financial groups. This opposition appeared under the so-called "fear of Wall Street."[1]

In the original Glass Bill, proposed by the House Committee, and given out unofficially June 17, 1913, there was proposed an entirely different system of organization and control. Instead of a National Reserve Association with fifteen branches, there was offered a decentralized organization of separate, incorporated, regional Reserve Banks, in as many districts, supervised by a Federal Reserve Board, having no capital and no banking functions.[2] Immediately attention was focused upon the composition

[1] In Congress it was emphatically stated that, irrespective of the merits of a Central Bank, it could not be proposed by Democrats, because it was forbidden by the Baltimore platform. It is difficult to reconcile this position with that taken in favor of abolishing all preferences to American coasting vessels going through the Panama Canal, which is in direct opposition to the platform of the Democratic party. The truth probably is that political advantage was gained by opposing a Central Bank. In addition, it may well be that regional banks were better suited to our conditions.

[2] Mr. Mann, the Republican leader in the House, said: "So far as we have been able to learn, the bill will be in the main pieces stolen from the Aldrich Monetary Commission Report, with a few radical provisions taken from the Bryan platform mixed in. It will be a jumble of discordant ideas" (June 23, 1913).

and powers of the Federal Reserve Board, since it was assumed that this board would have direction over the general banking operations of all the banks in the country, state or national, which might enter the new system. As to its composition, the original Glass Bill gave equal representation on the Federal Reserve Board to the lending bankers, the borrowing business public, and the government. A Board of nine members was to be composed of (1) the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency, ex officio; (2) three to be chosen by the President of the United States, of whom one would be designated as governor, etc.; and (3) three, presumably bankers, to be chosen by the Federal Reserve Banks.

When the bill came to be passed on by Democratic leaders, before it was adopted as an administration measure, the issue of control became prominent and drew great discussion. The administration demanded governmental control over the banking system, urging that bankers *per se* were the ones to be supervised, and, therefore, should not control the Federal Reserve Board (any more than railway men should control the Interstate Commerce Commission). Accordingly, the Glass Bill, before being presented to the Democratic Caucus of the House, changed the number of the Board from nine to seven, of whom the two cabinet officers and the Comptroller were to be ex officio members, and four others were to be appointed by the President, of whom one (later changed to two) should be a person experienced in banking. The original bill provided only that the governor of the Board could be removed by the President on a statement of the reasons; while in the changed bill the President was given power of removal for cause over the four members appointed by him for a term of ten years. On June 23, 1913, President Wilson read in person to Congress his currency message in which he said:

> The control of the system of banking and of issue which our new laws are to set up must be public, not private, must be vested in the government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative.

As opposed to this view the bankers held that they were obliged by the bill to enter the system, or lose their charters as national

banks; that a portion of their capital was "commandeered" for the stock of the new organizations, over which they were refused any control; that such a forced contribution without representation was practical confiscation; that such an invasion of the government into the realm of private ownership was "socialistic"; and that, in the analogy of the Interstate Commission, the Commission supervises, but does not pretend actually to operate, the railways, while the Federal Reserve Board is given direct control over banking operations. The American Bankers' Association, at Boston, October 8, 1913, opposed the compulsory contribution of capital without representation on the Board as follows:

> In return for the capital thus appropriated the banks receive a certificate, which cannot be sold, assigned, or hypothecated, over which none of the usual rights of property can be exercised. [National] banks are obliged to make this subscription, or be dissolved. Charters have ever been regarded in the nature of a contract, and it is doubtful if, under our Constitution, Congress can take away the charter of a bank in this summary manner, not because the terms of the charter have been violated by the banks, but because the bank management might refuse to make a coerced investment such as the pending measure provides.
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> . . . . If the government can appropriate one-tenth of a bank's capital in the manner provided by this bill this year, it may appropriate one-tenth the next year, and so on until the capital is all transferred to the government bank. If it can fix the compensation at 5 per cent this year, it may make it 4 per cent next year, and 3 per cent, 2 per cent, 1 per cent—a very simple and easy process whereby the entire capital of the banks may be transferred to the government.
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> . . . . This proposition of the government to take the banks' capital in the manner provided, carried to the extreme, would easily accomplish, so far as the national banks are concerned, this contention on the part of the Socialists. For those who do not believe in Socialism it is very hard to accept and ratify this proposed action on the part of the government.

To the bankers political control by appointees of the President, without banking experience, meant incompetent management. Consequently, they urged that three members of the Board should be elected by the directors of the Federal Reserve Banks.

Thus was the issue joined between government supervision and banking control. It is now obvious that the issue hinges on the powers granted to the Federal Reserve Board. If actual banking operations are carried on, not by the Reserve Board but by the

directors of the respective reserve banks, a majority of whose directors are chosen by the member banks, the question at issue practically disappears. What, then, are these powers?

In sec. 11 are enumerated the powers of the Federal Reserve Board:

(*a*) To examine, and require weekly statements of, reserve and member banks.
(*b*) To permit, or by a vote of five members to require, one Federal Reserve Bank to rediscount for another, and to fix the rate of discount charged in such a case.
(*c*) To suspend reserve requirements for not more than thirty days, provided a tax is imposed on Reserve Banks if reserves fall below a certain percentage.
(*d*) To supervise the issue and retirement of Federal Reserve notes.
(*e*) To add to, or reclassify, existing reserve or central reserve cities.
(*f*) To remove for cause any officer or director of any Reserve Bank.
(*g*) To require Reserve Banks to write off worthless assets.
(*h*) To suspend any Reserve Bank for violations of this act.
(*i*) To safeguard all collateral, notes, etc., deposited with its agents; and to make all rules necessary to enable the Board to perform the duties, functions, or services of this act.
(*j*) To exercise general supervision over Reserve Banks.
(*k*) To permit national banks to act as trustee, executor, etc., and establish rules therefor.
(*l*) To employ experts, assistants, clerks, etc., and fix their salaries and fees.

Besides the grant of these specific powers, additional powers[1] were granted in other sections throughout the act as follows:

1. To readjust Federal Reserve districts (sec. 2).
2. To regulate the establishment of branch banks within the respective Federal Reserve districts, and appoint three directors for each branch (sec. 3).
3. To designate three members (Class C) for each Federal Reserve Bank, one to be chairman of the board and known as the "Federal Reserve Agent"; and to secure impartial treatment to each member bank (sec. 4).
4. To call at discretion the unpaid half of capital stock; to determine the amounts returned to a bank withdrawing from membership (sec. 5); and to pass on the amount of any reduction of capital (sec. 28).

[1] Cf. *Report of House Committee on Banking and Currency*, September 9, 1913, No. 69, Sixty-third Cong., 1st sess., pp. 46–47.

5. To pass on applications for membership from state banks, and to establish by-laws therefor; to prescribe rules enforcing requirements of this act (sec. 9).
6. To require a member bank to surrender its stock, if it fails to comply with the law or rules of the Board (sec. 9).
7. To levy on the Reserve Banks a semi-annual assessment to cover the expenses of the Board (sec. 10).
8. To have general supervision over the Bureau of the Comptroller of the Currency (sec. 10).
9. To make an annual report to the Speaker of the House of Representatives (sec. 10).
10. To approve salaries and allowances granted to members of Advisory Council; and to call meetings of said Council (sec. 12).
11. To define the character of the paper eligible for rediscount by Reserve Banks; and to regulate discounts by said banks of bills receivable, bills of exchange, and acceptances (sec. 13).
12. To fix the percentage of the capital of a Reserve Bank which limits the discounts of agricultural paper having a maturity of not over six months (sec. 13).
13. To establish rules for dealings in cable transfers, acceptances, and bills of exchange, or in securities of the United States, or subdivisions thereof, by Reserve Banks (sec. 14).
14. To review rates of discount charged by Reserve Banks (sec. 14).
15. To pass on applications of Reserve Banks wishing to engage in foreign operations [sec. 14 (*e*)].
16. To issue at discretion Federal Reserve notes to Reserve Banks on deposit of an equal amount of collateral security; to call for additional security therefor; to assign a distinctive letter and serial number for notes issued by the respective Reserve Banks; to require each Reserve Bank to maintain at the United States Treasury a gold reserve (not less than 5 per cent) for its own notes; to grant or to reject any application for notes; to establish the rate of interest to be paid for such notes; to make rules allowing substitutions of collateral behind the notes; and to charge Reserve Banks with all expenses due to printing, issue, and retirement of such notes (sec. 16).
17. To fix charges for checks cleared through Reserve Banks and for transfer of funds among said banks (sec. 16).
18. To establish at its discretion a Clearing House for Reserve Banks, or one for member banks (sec. 16).
19. To require Reserve Banks to purchase United States bonds when member banks give them up to withdraw circulation, according to a given allotment (sec. 18).
20. To grant approval of refunding of 2 per cents into 3 per cents by the Secretary of the Treasury and Reserve Banks (sec. 18).

21. To permit a non-member to obtain discounts from a Reserve Bank through a member bank; to allow the reserve of a member bank with its Reserve Bank to be drawn upon under penalties; and to allow national banks in Alaska and outside the continental United States (except the Philippines) to join a reserve district (sec. 19).
22. To examine member banks; to accept in some cases examinations of member banks by state authorities; to fix salaries of examiners (instead of the present fee system); to permit special examinations; to demand information from a Reserve Bank at any time regarding a member bank; to order an examination of each Reserve Bank at least once a year (sec. 21).
23. To add to the list of cities in which national banks are not permitted to loan on real estate (sec. 24).
24. To approve or reject applications of national banks to establish foreign branches, and to order examinations of said branches (sec. 25).
25. To force a national bank to cease to act as a reserve agent, if it did not enter the system within 60 days after the act was passed (sec. 2).

A study of these powers of the Board shows that they are mainly supervisory or administrative after the general example of the powers of the Comptroller of the Currency over national banks. In a few respects, however, it may be said that the Board has more than supervisory powers.

In sec. 11 (*b*) and (*c*) the Board is given power to require one Reserve Bank to discount for another, and to suspend reserve requirements (for member banks as well as Reserve Banks) for not more than thirty days. This latter power, to be sure, has been exercised in effect by the Comptroller's discretion in not closing a bank whose reserves were below the legal limit. In making general definitions regarding eligible paper for discount (sec. 13), the action of the Board is still in the main supervisory. Moreover, it has only powers of review, not initiative, over the rate of discount set by the respective Reserve Banks (sec. 14). Also, the Board may reject applications from Reserve Banks for notes, but probably this authority is only to be exercised in order to restrict unhealthy expansion, or because the collateral was undesirable, and the like. In regard to establishing a system of clearings (sec. 16), however, the Board has powers of initiative which are certainly more than merely supervisory, touching not only the earnings, but the existing methods of business of member banks. Also quite as important

as any is the power to suspend any officer or director of any Reserve Bank [sec. 11 (*f*)], which means obviously any director elected by the banks as well as its own appointees. Yet it is to be observed that in no case is the Board empowered to conduct strictly banking operations of discount and deposit.

On the other hand, as distinctly opposed to the Federal Reserve Board, stand the Federal Reserve Banks, to whom are given all strictly banking functions of discount, deposit, and—in a practical sense—issue. While the bill was in the hands of the Senate committee an attempt was made, and supported by the Republican minority, to give direct banking powers to the Reserve Board, thus creating a type of central bank. Fortunately, this proposal failed. Consequently, the success of the new system must depend for its essential banking operations on the managements of the respective Reserve Banks.

As regards the general question of control, it is to be noted that there is a distinction to be made between governmental and political control. There may be governmental supervision and direction through the Reserve Board which is not political, provided the Board is not governed by political motives in its action. Appointment of members of the Board by the President should not mean political management any more than in the case of the supervision exercised by the Comptroller of the Currency over national banks in the past; or any more than presidential appointment of judges means political decisions on the law. More than this, it is to be kept in mind that the control of discounts and deposits, the primary functions in a banking system, is placed in the hands of the Boards of the respective Reserve Banks, the majority of whom are elected by member banks, and who should be men of practical banking experience. Thus, while there is governmental supervision by the Reserve Board, as above described, all questions of discounts and use of deposits, in the daily round of business, are left to technical bankers.

As to the possibility of changing the political character of the Reserve Board, let us assume that President Wilson is succeeded by a Republican on March 4, 1917. The Board is now being appointed in (say) April, 1914. Then the term of the member appointed for

4 years will expire in April, 1918; and of the one for 6 years, in April, 1920. Hence both of these positions, in addition to the appointment of the Secretary of the Treasury, may be filled by a new President. The term of office of the Comptroller of the Currency, appointed in 1914, being five years, his successor would be named by a new President. Thus a majority of the Board (four out of seven) could be reconstituted in the term of the next President.

The co-ordinating influence of a supervisory Board will go far to remedy the scattering of reserves formerly so great an evil; to establish continuity of policy; to gain co-operation between all the banks represented in the Reserve Banks; to check trouble in one district before it has extended to another; and, without the dreaded centralization, to have federation with local government in each district. Already concentration, without legal regulation, had appeared, but it had not prevented scattering of reserves, nor an individualistic condition of banking (very far from the common control that had been so much feared). The legal creation of a central body which could have been captured and used would have been a very much more dangerous thing. Regional banks, each sovereign in its own district as regards discounts, have probably removed this danger forever. Moreover, the Federal Advisory Council, one member chosen respectively by each Reserve Bank, gives the Board a nexus with conditions in all parts of the Union, and by the publicity of its opinions would exercise an influence proportionate to the soundness of its judgment.

VI

The legislative struggles gathered mainly about this question of central control. The nice point in the result was the right adjustment of the powers of the Over-Board as compared with those of the Reserve Banks. Here was the need of high legislative skill as well as of practical banking insight. The outcome is remarkable. It would have been easy to go too far in either direction. On the one hand, due to a current belief that a control over credits was possessed by the larger banks of New York City, there were many who regarded government control of banking credits as the only

means for securing equality of treatment. This attitude was a part of the present-day tendency to press for increasing governmental interference with trade and industry. While there was opposition to a central bank of private capital and of private management, there was more or less support for a central bank owned and controlled by the government. Thus, although there was a well-preserved tradition in the Democratic ranks (based on ignorance of the real services of the Second United States Bank, and which did them little credit) against a central bank, and although Democrats were supposed to dislike a centralization of political power, yet the opposition to the plan of the national Monetary Commission was clearly due, not so much to fear of a central bank, as to the fear of a privately capitalized central institution which might be controlled by the "interests."

On the other hand, sensible men of all parties realized that it would be impracticable to allow government officials, often political appointees, to do the actual work of technical banking, to grant loans, to manage resources and investments—in short, to introduce the government into the banking business. Political control was obviously as dangerous as private financial control; and it would have been destructively inefficient.

The solution of the matter finally adopted was, interestingly enough, centralization by districts; that is, a centralization intended to prevent scattering of reserves was obtained by establishing in each district an institution itself quite similar, in powers within its jurisdiction, to the National Reserve Association of the Monetary Commission. That is, the government was saved from going into the banking business by granting local centralization with capital and management supplied by the banks, and yet federated under a common authority in order to establish governmental direction and unity of purpose. In its essence this plan retained the workings of local self-government, together with the operation of technical banking by those who supplied the capital, under general direction. This final adjustment which secured safe and efficient methods, as contrasted with the chaotic proposals which might have been adopted, will be a cause of permanent congratulation. The nice balancing of powers between governmental

supervision and technical banking also appears in not going too far in local decentralization as illustrated in the development of our clearing-house operations. In these, because of the absence of any legal aids, local clearing-houses had been granting efficient banking service in times of panic, but in an isolated, unco-operative manner. Detachment went to extremes; each clearing-house was working less efficiently, because working by itself.

It is to be observed, moreover, that the solution adapted to our conditions, in which a widely scattered system of individual banks had to be retained, must be original with us. In no other country were the conditions the same. The relation of a Central Bank in European states to other banks was not one based on the existence of a system of individualistic and numerous banks carrying on independent operations. Therefore, while retaining self-management of privately owned banks, co-operation was obtained by Reserve Banks in local districts under management by bankers, while country-wide and uniform action was gained by governmental direction through a Federal Reserve Board.

The difficulty of sectional differences of interest working against each other would, nevertheless, have to be met in the practical workings of any plan. If there had been one central institution, pressure would have been brought upon the central management to help out one section of the country at the expense of another. Under a system of regional banks, each section gets the support of its own resources first of all, an arrangement by which sectional antagonism is reduced to the minimum. In addition, when one section is in trouble beyond its own powers of recovery, then by aid of the Reserve Board, one Reserve Bank may come to the aid of another. Such a practice, it is to be noted, has been going on in an extra-legal way in previous years whenever the banks of a large center have sought assistance from New York. Such a practice was natural and inevitable. In the new law such practice is openly recognized and legalized. It is, in effect, the same kind of action asked for by one borough, whose protective equipment has been taxed to excess by fire when it seeks the aid of another borough, not so threatened.

A Federal Reserve Bank is to be established in each of at least eight, and in not more than twelve, districts, "apportioned with due regard to the convenience and the customary course of business" in the continental United States, excluding Alaska (sec. 2). This is to be done by the organization committee, who have at this writing not yet reported. Not only existing business and transportation relations must be considered, but also the nature of the industries, in order that all the resources of a district should not be invested in only one kind of paper presented at the same time. Obviously delimitations of districts may seem geographically curious, but yet be industrially correct.

Each Reserve Bank will perform all the general functions of a typical bank, and its powers may briefly be enumerated as follows:

1. To incorporate, have succession for 20 years, and sue and be sued (sec. 4).
2. To appoint its own employees (sec. 4).
3. To have all the special powers granted in this act, and all those incidental to carrying on its business of banking (sec. 4).
4. To have a capital of not less than $4,000,000 (sec. 2).
5. To establish branches in its district, and designate four of the seven branch directors (sec. 3).
6. To pay dividends on stock, if earned (sec. 7).
7. To determine the relative amount of credit granted to each bank (sec. 4).
8. To obtain circulating notes after the manner of national banks in the interim before Reserve notes supersede national bank notes (secs. 4, 18).
9. To provide compensation for directors (sec. 4).
10. To be exempt from taxation (sec. 7).
11. To elect a member of the Advisory Council (sec. 12).
12. To pass on all discounts allowed by this act to member banks (sec. 13).
13. To fix the rate of discount to member banks (sec. 14).
14. To receive deposits from the Treasury or member banks, if it keeps 35 per cent reserves in gold or lawful money (secs. 13, 16).
15. To hold deposits from, and open accounts with, other Reserve Banks for exchange purposes (secs. 13, 14).
16. To buy and sell in the open market bankers' acceptances and bills (sec. 14).
17. To deal in gold coin at home and abroad; to borrow gold on security of government bonds, etc. (sec. 14).

18. To buy and sell at home and abroad government securities, bills, notes, revenue warrants, etc. (sec. 14).
19. To maintain agencies, correspondents, and banking accounts abroad for dealings in bills of exchange (sec. 14).
20. To receive government deposits, and act as fiscal agent for the United States (sec. 15).
21. To present commercial collateral and obtain Federal Reserve Notes, if it holds a 40 per cent reserve in gold for them (sec. 16).
22. To receive at par checks on member banks (sec. 16).
23. To become a clearing-house for its district (sec. 16).
24. To join in purchasing not over $25,000,000 per annum of United States bonds securing circulation, in allotments designated by the Reserve Board (sec. 18).
25. To have 2 per cent bonds refunded into 3 per cents (sec. 18).
26. To examine member banks and their foreign branches (sec. 21).

From this exposition it will be seen that each Federal Reserve Bank is to perform all the fundamental banking functions of issue, discount, and deposit; but that it is a bank for banks, and, with some exceptions to be noted later, not a bank for the public. Viewed from the standpoint of correcting existing evils in our banking and currency system, it will be found, from our later discussion, that the Federal Reserve Banks are established for the purpose of providing (1) through the issue function an elastic currency; (2) through the discount function the much-needed elasticity of credit by a reorganization of our credit structure; and (3) through the deposit function an effective mobilization of bank reserves to secure co-operation in times of stress; and (4) to abolish the antiquated independent Treasury system. More than that, a possibility of an extension of the clearings functions seems to open up.

These facts disclose clearly that the Reserve Banks form the backbone of the whole system, and that its success will depend directly upon their management. Here is the crux of the whole matter. Upon the directors of these banks lies the heaviest responsibility arising from the new law. It is very much to be doubted if legislators or the public realize the practical difficulty of finding the men competent to assume this responsibility, and of insuring a sound, intelligent, skilled, and judicious management. Consequently, the methods of choosing the directors and officials are of first importance. The nine directors of each Reserve Bank

have a term of three years, and are divided into three classes, A, B, and C (sec. 4). The three members of Class A are supposedly to be bankers, and are chosen by the member banks of the district. The directors of each member bank choose one elector; from the total list of persons nominated, one by each bank, the electors are to choose the three directors of Class A. At the same time and by the same electors, three directors for Class B are to be chosen in the same way, who shall be men actively engaged in commerce, agriculture, or industry within the district. The Reserve Board appoints the three members of Class C, who shall have been residents of the district for at least two years, and one of whom shall be designated as chairman of the Board of Directors and also as the "Federal Reserve Agent." In short, the constituent banks have the power to choose more than a majority (6) of the directors of each Reserve Bank, while the representative of the Reserve Board is always present. By this arrangement, technical banking operations are relegated to the Reserve Banks, and the responsibility for good or bad management is placed on the banks themselves, on the men whom they have elected.

In choosing the directors of Classes A and B, the member banks are to be divided into three general groups; "each group shall contain as nearly as may be one-third of the aggregate number of the member banks of the district and shall consist, as nearly as may be, of banks of similar capitalization" (sec. 4). Supposedly, the electors and nominees in each of these groups act separately. If so, the one-third of the banks, made up of those having the largest capital, being in one group, elect one of the directors in each class, A and B, respectively. Hence, the one-third of the whole number of banks in the district, made up of those having the smallest capital, being in one group, elect one director in Classes A and B, respectively. By this method the same number of banks having the largest capitalization have no more influence in electing directors than those having a small capital; which assumes that banks of small capital are as competent as large and successful banks to select the most capable directors. Here again is the fear of the "money-power."

Much discussion was also had on the most desirable number of

Reserve Banks. Irrespective of banking considerations, to politicians it was of course imperative to have one in each congressional "deestrict." To believers in a Central Bank, it was supposed that a small number, like four, could be made to work like one. The desire for decentralization, however, forced a larger number. But it was a mistake to fix upon any definite number at the outset. It would have been better to have started with the three Central Reserve cities (New York, Chicago, and St. Louis), having "regard to the convenience and customary course of business," and to have given the Reserve Board power to increase the number of districts as time and experience demanded. In the working of the law as it stands, we shall probably have another illustration of the impossibility of legislation to change materially the natural tendencies of trade. The Reserve Bank in New York City will be the largest and most influential because the banking capital and trade of New York City is, and will remain, the largest. In times of stress other parts of the country will continue to some extent to go to New York or Chicago for help, solely because it is the place where help can be had. Yet, apart from these considerations, it should not be forgotten that the mere size of the capital of a bank is no measure of its lending power. In neither men nor banks is size a warrant of virtue. The quality of its management, the amount of its deposits, the character of its discounts are all of more importance to the efficiency of a Reserve Bank than the amount of its capital.

So marked a departure from our past banking institutions and practices as is involved in the new law is certain to encounter obstacles. The very existence of discounts, and earnings thereon, in a Reserve Bank depends upon the rediscounting of paper received in the course of business by member banks who wish to get assistance from a Reserve Bank; and yet rediscounting has been generally regarded in this country as suspicious, or as an evidence of weakness. The practical underhanded devices by which the need, indicated by rediscounting, has been actually met would be wholly unnecessary under the new act. Obviously, if banks of high standing and strength have recourse, as they undoubtedly will, to rediscounting paper at a Reserve Bank, any small bank can do the same without

casting suspicion upon its condition. What is normal and usual will cease to excite comment. But since rediscounting has been resorted to in the past only when it was desired to strengthen a bank's reserves, it has been held by some experienced bankers that recourse to the Reserve Banks for rediscounts will be had only in times of stringency, and that in normal conditions of trade the Reserve Banks will do little business.

In anticipation of inactive funds, provision has been made to allow the Reserve Banks to engage in certain open-market operations. It is understood, of course, that it was expected these banks would discount only for member banks, and not for the public (except as later explained). The power to invest idle funds permits dealings at home or abroad in bonds and notes of the United States, and bills, notes, revenue bonds, and warrants maturing in not over six months to anticipate revenues of any state or other division of the United States, or of irrigation, drainage, or reclamation districts (sec. 14). Such dealings are to be carried on under rules of the Reserve Board, but the power is wide. Under "bills" is included, no doubt, "bills receivable," as mentioned in the section preceding (sec. 13). Such bills, as well as domestic bills of exchange, acceptances authorized by this act, cable transfers, bankers' acceptances, and bills of exchange "of the kinds and maturities by this act made eligible for rediscount, with or without the indorsement of a member bank" may be bought and sold "either from or to domestic or foreign banks, firms, corporations, or individuals" by a Reserve Bank (sec. 14). Here we have a surprisingly large departure from the limitation of business to member banks. It seems to suggest large possibilities of dealings with the public, if the paper is in the form of bills of exchange, etc. It is much to be doubted if the effect of these provisions has been fully foreseen.

As regards dealing in public securities, or foreign bills of exchange, there can be little question; but it is to be noted that dealings in the securities of foreign governments are not included. It was urged in behalf of a Central Bank that it was necessary to the maintenance of a sufficient fund of gold; and the experience of the Bank of France was an obvious example of what might be done.

It is now to be determined whether eight or more Reserve Banks can preserve our gold supply as well as one central institution, or as it was done through New York in the past voluntarily. Very much can, of course, be done to regulate the international flow of gold by skilful dealings in foreign exchange; but here we may have no unified action. On the other hand, we are a gold-producing country; and the Reserve Banks must start with strong gold reserves behind their liabilities. Yet, apart from expected movements of gold on a considerable scale, we must face the possibility of a great and unexpected emergency. It is well known that in the past we have had no official institution capable of negotiating for gold with the great European banks. Will a separate Reserve Bank be regarded as satisfactory? Perhaps the New York Reserve Bank will be the one large enough to be relied on. However that may be, each Reserve Bank is given specific power "to deal in gold coin and bullion at home or abroad" and "to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds or other securities which Federal Reserve banks are authorized to hold" (sec. 14). Here will come in the suitability of the one-year 3 per cent notes not having the circulation privilege given in exchange for 2 per cent bonds having the circulation privilege (sec. 18).

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